23 VAC 10-120. CORPORATION INCOME TAX

~~23 VAC 10-120-50. Excess cost recovery.~~

~~A. In general. The purpose of the adjustments described by this section is to phase in the federal Accelerated Cost Recovery System (ACRS). All taxpayers must make an addition on their Virginia income tax returns for taxable years 1982 and thereafter which is equal to 30% of the ACRS deduction claimed on their federal income tax returns. For taxable years 1984 and thereafter a subtraction is allowed which is equal to a percentage of the ACRS additions made by the taxpayer in the taxpayer's Virginia income tax returns.~~

~~B. Addition.~~

~~1. Any taxpayer claiming a deduction for ACRS on the federal return is required to add 30% of the federal ACRS deduction to Virginia taxable income. The addition is required regardless of the location of the property and regardless of the recovery method elected under ACRS.~~

~~2. The addition is equal to 30% of the ACRS deduction except that no addition shall be made for any federal deduction claimed with respect to property not used to produce Virginia taxable income (such as foreign source income).~~

~~3. The following refers to items on federal form 4562, Depreciation and Amortization for 1984.~~

~~a. No addition is required for the deduction under the election to expense recovery property. IRC §179.~~

~~b. The addition is required for all recovery property (3-year, 5-year, 10-year, 15-year public utility, 15-year real property-low income housing, 15-year real property other than low income housing, 18-year real property) regardless of recovery period or method used or year placed in service.~~

~~c. No addition is required for property subject to IRC §168(e)(2) election to use a method not based on a term of years.~~

~~d. No addition is required for depreciation or amortization of non-recovery property.~~

~~4. Partnerships, estates, trusts and electing small business corporations (Subchapter S) report the ACRS addition on their Virginia returns. The ACRS addition is included in the additions and subtractions reported to each partner, beneficiary and shareholder in accordance with the distributive share for the taxable year.~~

~~5. When less than 100% of a taxpayer's income is from Virginia sources the addition is made as follows:~~

~~a. Resident individuals add 30% of the federal ACRS deduction regardless of where the property is located. No deduction, exclusion, exemption or proration of the addition is allowed except with respect to property used to produce foreign source income.~~

~~b. Nonresident individuals add 30% of the federal ACRS deduction in the same manner as resident individuals. The addition will be adjusted by the percentage of Virginia income in the computation of Virginia taxable income.~~

~~c. Part-year residents add 30% of only the portion of the federal ACRS deduction earned while a resident of Virginia. The federal ACRS deduction shall be prorated based on the number of days of residence regardless of when the property is acquired or where the property is located.~~

~~d. Corporations add 30% of the federal ACRS deduction. Those corporations eligible to allocate and apportion income will adjust the ACRS addition as part of apportionment computations.~~

~~e. Partnerships, electing small business corporations (Subchapter S corporations), estates and trusts add 30% of the federal ACRS deduction. If a partnership, electing small business corporation, estate or trust has income from sources in Virginia and other states, and has partners, shareholders or beneficiaries who are not residents of Virginia, then the nonresident's share of~~

~~the additions and subtractions shall be determined in accordance with generally accepted accounting principles.~~

~~C. Subtraction. For taxable years beginning on or after January 1, 1984, taxpayers may subtract a portion of the ACRS additions made in the taxpayer's Virginia income tax returns for 1982 and thereafter. The subtraction is computed as follows:~~

~~1. The ACRS additions for all taxable years beginning and during calendar years 1982 and 1983 are totaled. Twenty percent of this total may be subtracted in the first taxable year beginning on or after January 1, 1984 and in each of the four succeeding taxable years.~~

~~2. The ACRS additions for the two taxable years beginning on or after January 1, 1984 are totaled. Twenty percent of this total may be subtracted in the third taxable year beginning after January 1, 1984 and in each of the four succeeding taxable years.~~

~~3. This addition and subtraction cycle continues indefinitely. Thus, additions made in the third and fourth taxable years beginning after January 1, 1984 will be subtracted in the fifth through the ninth taxable years; additions made in the fifth and sixth taxable years will be subtracted in the seventh through the eleventh taxable years.~~

~~4. Short taxable years beginning after January 1, 1984 are treated as ordinary taxable years. However, the first biennium, calendar years 1982 and 1983, includes all taxable years beginning during 1982 and 1983.~~

~~5. Example. Corporation A was organized on January 20, 1982 and filed its first tax return electing a taxable year ending June 30, 1982. In 1986 A was acquired by another corporation and filed a short year return for the period July 1, 1986 to December 31, 1986 in order to be included in the acquiring corporation's consolidated federal return. A continued to file a separate Virginia return. The first biennium contains three taxable years beginning January 20, 1982, July 1, 1982 and July 1, 1983. The ACRS additions for these three years total $900, twenty percent of which ($180) will be subtracted in taxable years ending on June 30, 1985, June 30, 1986, December 31, 1986, December 31, 1987 and December 31, 1988. The ACRS additions for the second biennium (taxable years ending on June 30, 1985 and June 30, 1986) total $600, twenty percent of which ($120) will be subtracted in taxable years ending December 31, 1986, December 31, 1987, December 31, 1988, December 31, 1989 and December 31, 1990.~~

~~ACRS~~

~~Taxable Year Ended~~	~~ACRS Addition On Va. Return~~	~~Total for Biennium~~	~~Subtraction On Va. Return~~
~~6/30/82~~	~~300~~		~~None~~
~~6/30/83~~	~~300~~		~~None~~
~~6/30/84~~	~~300~~	~~900~~	~~None~~
~~6/30/85~~	~~300~~		~~180~~

~~---~~

~~6/30/86 300 600 180~~

~~---~~

~~12/31/86 210 180~~

~~+120 300~~

~~---~~

~~12/31/87 300 510 180~~

~~+120 300~~

~~---~~

~~12/31/88 300 180~~

~~+120~~

~~+102 402~~

~~--~~

~~12/31/89 300 600 120~~

~~+102 222~~

~~--~~

~~12/31/90 300 120~~

~~+102~~

~~+120 342~~

~~--~~

~~D. Special situations.~~

~~1. Additions. For taxable years beginning during 1982 and 1983, any taxable entity filing a federal return in which an ACRS deduction is claimed must add 30% of such deduction in computing Virginia taxable income. No subtraction may be claimed in 1982 and 1983 returns regardless of the taxpayer's situation.~~

~~2. Additions by other taxpayers.~~

~~a. Except for those situations set forth below, a taxpayer may claim a subtraction for only those ACRS additions made by the taxpayer. For this purpose a partner, beneficiary or shareholder is NOT deemed to have made ACRS additions reported by partnerships, estates, trusts and electing small business corporations (Subchapter S corporation). A partner, for example, may claim an ACRS subtraction only to the extent that it is included in the partner's distributive share of the income, loss, additions and subtractions for the taxable year. No adjustments are required due to any changes in the partner's ownership interest between the time the ACRS addition is made by the partnership and the time the ACRS subtraction is claimed by the partnership.~~

~~b. Any taxpayer (other than a surviving spouse) claiming a subtraction based upon ACRS additions made by any other taxable entity must attach to the return a statement setting forth the name and taxpayer I.D. No. of such other taxable entity, details of the ACRS additions and previous subtractions claimed by such~~

~~other taxable entity, an explanation of the relationship between the taxpayer and such other taxable entity and a statement signed by the taxpayer to the effect that the subtraction claimed has not, and will not, be claimed by any other person on any other return, including the final return of such other taxable entity.~~

~~c. A corporation may claim a subtraction based upon ACRS additions made by another corporation if there has been a merger or other form of reorganization and the corporation claiming the subtraction would be allowed under federal law to claim a net operating loss deduction based upon a net operating loss incurred by the corporation which made the ACRS additions, assuming such corporation had incurred a net operating loss.~~

~~d. A surviving spouse may claim a subtraction based upon ACRS additions made by the decedent and the surviving spouse on a joint or combined Virginia income tax return. The statement referred to in paragraph b above is not required.~~

~~3. When less than 100% of a taxpayer's income is from Virginia sources the subtraction is claimed in the same manner as additions. See subsection A 5 above.~~

~~23 VAC 10-120-60. Excess cost recovery; definitions.~~

~~The following words and terms, when used in this chapter, shall have the following meanings unless the context clearly indicates otherwise:~~

~~"ACRS addition" means an excess cost recovery addition actually reported under §58-151.013(b)(6) (prior to the recodification of Title 58), §58.1-322 B 6 (for individuals) and §58.1-402 B 3 (for corporations) of the Code of Virginia, on any return filed for a taxable year beginning between January 1, 1982 and December 31, 1987.~~

~~"ACRS subtraction" means an excess cost recovery subtraction allowable under §58-151.013(c)(10) (prior to the recodification of Title 58), §58.1-322 C 8 (for individuals) and §58.1-402 C 9 (for corporations) of the Code of Virginia, for any taxable year beginning after December 31, 1983, but before January 1, 1988, regardless of whether or not a return was filed to claim the allowable subtraction.~~

~~"Corporation" means any person or entity subject to tax or required to file a return under Article 10, Chapter 3 (§58.1-400 et seq.) of Title 58.1 of the Code of Virginia.~~

~~"Individual" means any natural person, married or unmarried, who is subject to taxation or required to file a return under Article 2 of Chapter 3 (§58.1-300 et seq.) of Title 58.1 of the Code of Virginia.~~

~~"Outstanding balance of excess cost recovery" means the amount equal to the difference between:~~

~~1. The sum of the ACRS additions actually reported on Virginia returns filed for taxable years beginning on and after January 1, 1982, and before January 1, 1988; and~~

~~2. The sum of the ACRS subtractions allowed or allowable on Virginia returns, regardless of whether or not a Virginia return was actually filed, for taxable years beginning on and after January 1, 1984, and before January 1, 1988.~~

~~"Post-1987 ACRS subtraction" means the portion of the outstanding balance of excess cost recovery which may be subtracted by individuals on returns for taxable years beginning on or after January 1, 1988, and before January 1, 1990, or by corporations on returns for taxable years beginning on or after January 1, 1988, and before January 1, 1993.~~

~~23 VAC 10-120-61. Excess cost recovery; purpose.~~

~~A. Generally. The Virginia Tax Reform Act of 1987 added §58.1-323.1 of the Code of Virginia which phases out the excess cost recovery program through the allowance of post-1987 subtractions effective for taxable years beginning on and after January 1, 1988. In 1988 §58.1-323.1 was amended to permit a refund if a~~

~~final federal and Virginia return was filed for a taxable year beginning prior to January 1, 1988. This regulation sets forth the rules applicable to both individual and corporate taxpayers. In most cases the outstanding balance of excess cost recovery may be recouped through annual post-1987 subtractions over a two year period for individual taxpayers and a five year period for corporate taxpayers (see 23VAC10-120-63). Generally, if a taxpayer has insufficient income to benefit from a subtraction in a particular year, all or part of the subtraction may be carried over to the next year (see 23VAC10-120-64). A taxpayer who files a final federal and Virginia return may claim an immediate subtraction for the unrecovered outstanding balance of excess cost recovery (see 23VAC10-120-65). If at the conclusion of the applicable subtraction period (1989 for individuals and 1992 for corporations), or after filing a final federal and Virginia return, the taxpayer still has not recouped the outstanding balance of excess cost recovery, the taxpayer may qualify to file an application for a refund (see 23VAC10-120-66).~~

~~B. Exclusive method. Effective for taxable years beginning on and after January 1, 1988, the post-1987 subtractions and refunds allowable under this regulation shall be the exclusive means of recovering the outstanding balance of excess cost recovery.~~

~~23VAC10-120-62. Excess cost recovery; computation of the outstanding balance of excess cost recovery.~~

~~A. Generally. A taxpayer's outstanding balance of excess cost recovery is computed only with respect to ACRS additions attributable to federal ACRS deductions on property owned directly by the taxpayer or deemed to be owned by the taxpayer for federal income tax purposes, and ACRS subtractions attributable to such ACRS additions. For the treatment of ACRS additions and ACRS subtractions passed through from a conduit entity see 23VAC10-120-63 D.~~

~~B. Computation.~~

~~1. The outstanding balance of excess cost recovery includes the sum of ACRS additions actually reported on a Virginia return for taxable years beginning on and after January 1, 1982, and before January 1, 1988. If no Virginia return was filed for a taxable year then no ACRS addition with respect to such taxable year may be included in the outstanding balance of excess cost recovery.~~

~~2. For most taxpayers the information necessary to compute the "outstanding balance of excess cost recovery" can be found on the Form 302 included with the Virginia returns for taxable years 1986 and 1987.~~

~~a. The "ACRS additions" for taxable years 1982, 1983, 1984, and 1985 can be found in Column B of part II of the Form 302 attached to the 1986 and 1987 returns.~~

~~b. The "ACRS additions" for taxable years 1986 and 1987 can be found in Part I of the Form 302 attached to the 1986 and 1987 returns, respectively.~~

~~3. The outstanding balance of excess cost recovery is reduced by the sum of ACRS subtractions which would have been allowable with respect to each biennium's ACRS additions, whether or not a return was actually filed claiming an ACRS subtraction in each taxable year beginning on and after January 1, 1984, and before January 1, 1988.~~

~~a. The ACRS subtractions which would have been allowable with respect to the first biennium, 1982/1983, are the sum of the ACRS additions actually reported on a Virginia return for all taxable years beginning on and after January 1, 1982, and before January 1, 1984, multiplied by 80% (the percentage allowed or allowable in the four taxable years following the close of the 1982/1983 biennium, i.e., 20% X 4) or by 100% (see subdivision (2) of this subdivision).~~

~~(1) The number of taxable years included in the first biennium may be one, two, or more, depending upon when the taxpayer was required to file a Virginia return and whether returns for short taxable years were filed during the period.~~

~~(2) If one or more returns for a short taxable year were filed for a period beginning after the close of the 1982/1983 biennium the percentage allowed or allowable may be 100% for the first biennium (20% X 5).~~

~~b. The ACRS subtractions which would have been allowable with respect to the second biennium, 1984/1985, are the sum of the ACRS additions actually reported on a Virginia return for the first two taxable years beginning on and after January 1, 1984, multiplied by 40% (the percentage allowed or allowable in the two taxable years following the close of the 1984/1985 biennium, i.e., 20% X 2).~~

~~(1) The number of taxable years included in the second biennium will be two unless the taxpayer did not file a return or only filed one Virginia return during the period beginning after January 1, 1984.~~

~~(2) The percentage allowed or allowable may be more or less than 40% if one or more returns for a short taxable year were filed for a period beginning on and after January 1, 1984, or if the taxpayer was not required to file a Virginia return for a period beginning before January 1, 1985.~~

~~(3) For example: If a calendar year taxpayer first became subject to Virginia income tax in 1985, there would be no ACRS subtractions with respect to the first biennium because no returns were filed in 1982 and 1983; therefore, no ACRS additions were reported. The ACRS subtractions with respect to the second~~

~~biennium would be based on ACRS additions reported on the 1985 and 1986 Virginia returns multiplied by 20% (i.e., 20% X 1, the number of taxable years beginning after the close of the second biennium and before January 1, 1988).~~

~~c. The ACRS subtractions which would have been allowable with respect to the third biennium, 1986/1987, will be zero unless one or more returns for a short taxable year were filed for a period beginning on and after January 1, 1984.~~

~~23 VAC 10-120-63. Excess cost recovery; post-1987 ACRS subtractions.~~

~~A. Generally.~~

~~1. Except as otherwise provided in 23VAC10-120-64 through 23VAC10-120-67, the outstanding balance of excess cost recovery as computed in 23VAC10-120-62 shall be claimed as post-1987 ACRS subtractions on returns filed for taxable years beginning on and after January 1, 1988, as set forth in this section.~~

~~2. A taxpayer's post-1987 ACRS subtraction for a taxable year is the sum of:~~

~~a. The post-1987 ACRS subtraction computed as set forth in this section with respect to the outstanding balance of excess cost recovery attributable to federal ACRS deductions on property owned directly by the taxpayer or deemed to be owned by the taxpayer for federal income tax purposes, and~~

~~b. The post-1987 ACRS subtraction computed as set forth in this section with respect to the outstanding balance of excess cost recovery computed in accordance with 23VAC10-120-62 B by a conduit entity and passed through to the taxpayer in accordance with subsection D of this section.~~

~~B. Individuals.~~

~~1. 1988. For the taxable year beginning in 1988 the post-1987 ACRS subtraction is equal to two-thirds of the outstanding balance of excess cost recovery.~~

~~2. 1989. For the taxable year beginning in 1989 the post-1987 ACRS subtraction is equal to one-third of the outstanding balance of excess cost recovery.~~

~~3. 1990 and after. If a post-1987 subtraction is included in the Virginia modifications distributed by an S corporation, partnership, estate or trust for its fiscal year ending after December 31, 1989, the individual may elect to include such amounts in the individual's subtractions for the taxable year, or may claim a refund under 23VAC10-120-66.~~

~~C. Corporations.~~

~~1. 1988. For the taxable year beginning in 1988 the post-1987 ACRS subtraction is equal to 10% of the outstanding balance of excess cost recovery.~~

~~2. 1989. For the taxable year beginning in 1989 the post-1987 ACRS subtraction is equal to 10% of the outstanding balance of excess cost recovery.~~

~~3. 1990. For the taxable year beginning in 1990 the post-1987 ACRS subtraction is equal to 30% of the outstanding balance of excess cost recovery.~~

~~4. 1991. For the taxable year beginning in 1991 the post-1987 ACRS subtraction is equal to 30% of the outstanding balance of excess cost recovery.~~

~~5. 1992. For the taxable year beginning in 1992 the post-1987 ACRS subtraction is equal to 20% of the outstanding balance of excess cost recovery.~~

~~D. Conduit entities.~~

~~1. A conduit entity (estate, trust, partnership and S corporation) shall compute its outstanding balance of excess cost recovery in accordance with 23VAC10-120-62 B.~~

~~2. In each taxable year beginning on and after January 1, 1988, and before January 1, 1990, a conduit entity shall compute the post-1987 ACRS subtraction in accordance with subsection B of this section relating to individuals without regard to whether or not the beneficiary, fiduciary, partner or shareholder is an individual, and shall provide each beneficiary, partner or shareholder with sufficient information to report the appropriate post-1987 ACRS subtraction.~~

~~3. If a conduit entity files a short year return for the fiscal year ended December 31, 1987, in order to change its taxable year to a calendar year, each beneficiary, partner, or shareholder may, in certain circumstances, elect to spread the income from the conduit entity's short taxable year over four taxable years for federal income tax purposes. If such an election is made:~~

~~a. One-quarter of the conduit entity's Virginia modifications for the short taxable year (including the ACRS addition and ACRS subtraction) must be included in the 1987 Virginia taxable income of the beneficiary, partner, or shareholder;~~

~~b. One-quarter of the conduit entity's Virginia modifications for the short taxable year (excluding the ACRS addition and ACRS subtraction) must be included in the Virginia taxable income of the beneficiary, partner, or shareholder in each of the three following taxable years; and~~

~~c. The beneficiary, partner, or shareholder shall adjust the the post-1987 ACRS subtraction passed through from the conduit entity in each taxable year as follows: (i) For 1988, by subtracting one-half of the conduit entity's 1987 ACRS addition and adding one-half of the conduit entity's 1987 ACRS subtraction; (ii) For 1989, by subtracting one- quarter of the conduit entity's 1987 ACRS addition and adding one-quarter of the conduit entity's 1987 ACRS subtraction.~~

~~d. Example. An S corporation was formed in July 1985 and elected a fiscal year ending June 30. It reported and passed through ACRS additions of $200 in each of its F.Y.E. 6/30/86 and 6/30/87. There were no other Virginia additions or subtractions. The S corporation filed a short-year return for F.Y.E. 12/31/87 reporting an ACRS addition of $100 and an ACRS subtraction of $80. The sole shareholder of the S corporation elected to spread the short-year income over four years for federal purposes, reporting only $25 and $20 of the short-year ACRS additions and subtractions in 1987. In 1988 the S corporation passed through a post- 1987 subtraction of $280 (⅔ of $500 - $80). Because of the shareholder's election the $280 must be reduced by ½ of the F.Y.E. 12/31/87 addition (½ of 100 = 50) and increased by ½ of the F.Y.E. 12/31/87 subtraction (½ of 80 = 40) for a net modification of $270. The net effect of these modifications is represented in the following table:~~

~~Total Reported in Shareholder's~~

~~Passed Virginia Return For~~

~~Modification Through 1986 1987 1988 1989~~

~~--~~

~~F.Y.E. 6/30/86~~

~~ACRS Addition 200 200~~

~~F.Y.E. 6/30/87~~

~~ACRS Addition 200 200~~

~~F.Y.E. 12/31/87~~

~~ACRS Addition 100 25 50 25~~

~~F.Y.E. 12/31/87~~

~~ACRS Subtract.~~	~~(80)~~		~~(20)~~	~~(40)~~	~~(20)~~
~~Post-1987 ACRS~~					
~~Subtraction~~	~~(420)~~			~~(280)~~	~~(140)~~
~~Net Modifications~~	~~0~~	~~200~~	~~205~~	~~(270)~~	~~(135)~~

~~E. Short taxable year.~~

~~1. If there is more than one taxable year beginning on or after January 1, 1988, because of a taxable year of less than 12 months, the allowable portion of the subtraction shall be prorated between all taxable years which begin in the same calendar year. The proration will be based on the number of months in each~~

~~taxable year divided by the total number of months in all taxable years beginning during the calendar year.~~

~~2. Example. XYZ, Inc. files on a calendar year basis. On December 31. 1987, XYZ, Inc. is acquired by Holding, Inc., which files its returns on the basis of a fiscal year ending on September 30. In order to be included in a consolidated return with Holding, Inc., XYZ, Inc. files two returns for taxable years beginning in 1988 - a short-year return for the period January 1, 1988, through September 30, 1988, (nine months) and a return for the period October 1, 1988, through September 30, 1989, (12 months). Because there are two taxable years beginning in 1988, which cover a total of 21 months, the post-1987 ACRS subtraction for 1988 (10% of the outstanding balance of excess cost recovery) must be prorated between the nine-month taxable year and the 12-month taxable year as follows:~~

~~Taxable year 1/1/88 - 9/30/88: 10% x 9/21 = 4.29%~~

~~Taxable year 10/1/88 - 9/30/89: 10% x 12/21 = 5.71%~~

~~Total subtractions for 1988 = 10.00%~~

~~F. Former S corporation.~~

~~1. If an S corporation becomes taxable under subchapter C of the IRC, its post-1987 ACRS subtraction for taxable years after termination of the election shall be the amount by which:~~

~~a. The total post-1987 ACRS subtractions for the current and all prior taxable years computed under subsection C of this section relating to corporations, exceeds~~

~~b. The total post-1987 ACRS subtractions which were actually passed through to beneficiaries, partners and shareholders by the former S corporation or which were claimed by the corporation after it ceased to qualify as an S corporation.~~

~~2. Example. An S corporation is acquired by another corporation as of the first day of 1989, thereby terminating its status as an S corporation for 1989. Two-~~

~~thirds of the outstanding balance of excess cost recovery was passed through to the former S corporation's shareholders in 1988. The remaining one-third will be subtracted as follows:~~

~~Post-1987 ACRS Subtraction~~	~~1989~~	~~1990~~	~~1991~~	~~1992~~
~~1. Percent allowable for current and prior years~~	~~20%~~	~~50%~~	~~80%~~	~~100%~~
~~2. Percent previously passed~~				

~~through or allowed 66.7% 66.7% 66.7% 80%~~

~~3. Percent allowable for~~

~~current year (L. 1 minus~~

~~L. 2, but not less than 0) 0.0% 0.0% 13.3% 20%~~

~~3. If a corporation makes a valid election to be taxed under subchapter S of the IRC after 1987, any post-1987 ACRS subtraction which has not been used by the corporation shall be passed through to its shareholders in accordance with subsection D of this section. However, if the election is made for a taxable year~~

~~beginning on and after January 1, 1990, no amount shall be passed through to the shareholder under subsection D of this section, but the corporation shall be eligible to apply for a refund under 23VAC10-120-66.~~

~~23VAC10-120-64. Excess cost recovery; carryover of unused subtractions.~~

~~A. Individuals.~~

~~1. Any individual who has insufficient income to offset the full amount of the post-1987 ACRS subtraction shall add the amount not offset to the amount allowable for the following taxable year. No amount may be subtracted under this subdivision in any taxable year beginning on or after January 1, 1990. An individual who has not recovered the full amount of the outstanding balance of excess cost recovery under this section or under 23VAC10-120-63 on his income tax returns filed for taxable years 1988 and 1989, may qualify to file an application for a refund under 23VAC10-120-66.~~

~~2. The portion of any post-1987 ACRS subtraction available for carryover is the lesser of:~~

~~a. The amount by which Virginia taxable income is less than zero, or~~

~~b. The post-1987 ACRS subtraction for the taxable year including amounts carried over from a prior year under this section.~~

~~3. A taxpayer may not elect to claim less than the allowable post-1987 ACRS subtraction in any year in order to take advantage of a credit, or for any other reason.~~

~~4. Example.~~

~~a. Taxpayer A, an individual filing on a calendar year, has an outstanding balance of excess cost recovery equal to $9,000 after taxable year 1987. For calendar year 1988 he is single with federal adjusted gross income of $12,350 and Virginia itemized deductions of $7,250. For Virginia income tax purposes, he has no additions to federal adjusted gross income and he has no subtractions from federal adjusted gross income other than his post-1987 ACRS subtraction. His carryover from taxable year 1988 to 1989 is $1,700, which is computed in the following manner:~~

~~Federal Adjusted Gross Income $12,350~~

~~Va. Personal Exemption - 800~~

~~Va. Itemized Deductions - 7,250~~

~~Post-1987 ACRS Subtraction~~

~~($9,000 x 2/3) - 6,000~~

~~-------~~

~~Va. Taxable Income - 1,700~~

~~b. Taxpayer A would be allowed to carryover $1,700 of his post-1987 ACRS subtraction for 1988 to 1989 and add it to the post-1987 ACRS subtraction ($3,000) otherwise allowable as a subtraction in 1989. Therefore, in 1989 Taxpayer A will have a total post-1987 ACRS subtraction of $4,700 ($1,700 carryover from 1988 + $3,000 for 1989).~~

~~c. Taxpayer A may not claim a post-1987 ACRS subtraction of less than $6,000 in 1988 (increasing the amount carried over to 1989) in order to take advantage of an energy income tax credit carried over from 1987 (which cannot be carried over to 1989).~~

~~B. Corporations.~~

~~1. Any corporation which has insufficient income to offset the full amount of the post-1987 ACRS subtraction shall add the amount not offset to the amount allowable for the following taxable year. No amount may be subtracted under this subdivision in any taxable year beginning on or after January 1, 1993. Any corporation that has not recovered the full amount of the outstanding balance of excess cost recovery under 23VAC10-120-63 or under this section on income tax returns filed for taxable years beginning on or after January 1, 1988, but before~~

~~January 1, 1993, may qualify to file an application for a refund under 23VAC10-120-66.~~

~~2. The amount of the post-1987 ACRS subtraction available for carryover is the lesser of:~~

~~a. The amount by which Virginia taxable income is less than zero, or~~

~~b. The post-1987 ACRS subtraction for the taxable year including amounts carried over from a prior year under this section.~~

~~3. Example. ABC, Inc. has an outstanding balance of excess cost recovery equal to $120,000 after taxable year 1987. Under 23VAC10-120-63 the allowable post-1987 ACRS subtraction is $12,000 for 1988 and 1989, $36,000 for 1990 and 1991, and $24,000 for 1992. ABC has losses or income which are insufficient to absorb the full amount of the post-1987 ACRS subtractions in every year. The Virginia taxable income and carryover would be computed as follows:~~

~~Taxable year~~	~~1988~~	~~1989~~	~~1990~~	~~1991~~	~~1992~~

~~Taxable Income Before~~

~~Post 1987 ACRS~~

~~Subtraction: 10,000 -5,000 28,000 78,000 36,000~~

~~Post-1987 ACRS Subtractions~~

~~for current year: 12,000 12,000 36,000 36,000 24,000~~

~~from prior year: N/A 2,000 14,000 22,000 0~~

~~Taxable Income: -2,000 -19,000 -22,000 20,000 12,000~~

~~Post-1987 ACRS Subtractions~~

~~available for next year: 2,000 14,000 22,000 0 N/A~~

~~"N/A" means a carryover is not available to or from the taxable year.~~

~~C. Conduit entities. Estates, trusts, partnerships and S corporations do not carry over post-1987 ACRS subtractions under this section. Amounts distributed under~~

~~subsection D of 23VAC10-120-63 may be carried over by the beneficiaries, partners or shareholders.~~

~~D. Nonresidents. If a nonresident has income from Virginia sources or is required to file a Virginia return the nonresident may claim a post-1987 ACRS subtraction and carryover unused amounts under this section.~~

~~23 VAC 10-120-65. Excess cost recovery; final return.~~

~~When any taxpayer has filed a final federal return due to the death of an individual or the dissolution of a partnership, estate, trust, or corporation, for a taxable year beginning on and after January 1, 1988, the taxpayer may claim the entire outstanding balance of excess cost recovery (less amounts already claimed as a post-1987 ACRS subtraction) on the final Virginia return.~~

~~a. Conduit entities. Amounts claimed on the final Virginia return of an estate, trust, partnership or S corporation shall be distributed in accordance with subsection D of 23VAC10-120-63.~~

~~b. Other taxpayers. If the taxpayer has insufficient income on the final Virginia return to offset the entire amount allowable under this subdivision, an application for the refund of unrecovered taxes paid on the outstanding balance of excess cost recovery may be filed under 23VAC10-120-66.~~

23 VAC 10-120. CORPORATION INCOME TAX

~~The fact that a taxpayer files a final Virginia return because an individual has moved from Virginia or a business has discontinued operations in Virginia shall not entitle the taxpayer to the immediate subtraction or refund allowed in subdivision A 1 of 23VAC10-120-66.~~

~~23 VAC 10-120-66. Excess cost recovery; application for refund.~~

~~A. Generally.~~

~~1. Any taxpayer who can demonstrate that the entire outstanding balance of the excess cost recovery as computed in 23VAC10-120-62 has not been recovered through post-1987 ACRS subtractions allowable under 23VAC10-120-63 or 23VAC10-120-64 by such taxpayer or any other taxpayer may apply for a refund of unrecovered taxes paid on the outstanding balance of excess cost recovery.~~

~~2. When any taxpayer has filed a final federal return due to the death of an individual or the dissolution of a partnership, estate, trust, or individual, an application for the refund of unrecovered taxes paid on the outstanding balance of excess cost recovery may be filed by the person authorized to act on behalf of the deceased or dissolved taxpayer.~~

~~3. The fact that a taxpayer files a final Virginia return because an individual has moved from Virginia or a business has discontinued its operations in Virginia shall not entitle the taxpayer to apply for a refund under this section.~~

~~4. Estates, trusts, partnerships and S corporations shall not apply for a refund under this section except to the extent that the fiduciary of an estate or trust paid tax on undistributed income.~~

~~5. No refund shall be allowed under this section unless the taxpayer has income from Virginia sources or is required to file a Virginia return for each taxable year in which a subtraction is allowed under 23VAC10-120-63 or, if earlier, for each taxable year until a final federal return is filed.~~

~~B. Computation of the refund amount.~~

~~1. The refund shall be computed upon the amount of the outstanding balance of excess cost recovery which has not been recovered through post-1987 ACRS subtractions allowable under 23VAC10-120-63 or 23VAC10-120-64. This amount shall be multiplied by 5.75% (0.0575) in the case of an individual or by 6.0% (0.06) in the case of a corporation.~~

~~2. In no case shall the amount of refund allowed under this section exceed the amount of tax that was actually paid on the outstanding balance of excess cost~~

~~recovery and not otherwise recovered through post-1987 ACRS subtractions. For the purpose of computing the limitation under this subdivision:~~

~~a. The refund shall be limited to the amount by which (i) the sum of the difference between the tax actually paid and the tax computed without the ACRS addition and ACRS subtraction for each taxable year beginning on and after January 1, 1982, and before January 1, 1988, exceeds (ii) the sum of the difference between the tax actually paid and the tax computed without the post-1987 ACRS subtraction for each taxable year beginning on and after January 1, 1988.~~

~~b. A beneficiary may include tax paid by an estate or trust with respect to a distribution of accumulated income.~~

~~c. A shareholder of an S corporation may include the distributive share of tax paid by the corporation in years before it elected S corporation status.~~

~~d. In the case of a net operating loss, a taxpayer may include either:~~

~~(1) Virginia income tax paid in the year of the loss (if any), or~~

~~(2) Virginia income tax paid in a year to which any portion of the loss year ACRS addition and ACRS subtraction may have been carried with a federal net operating loss deduction.~~

~~e. In the case of a corporation required to allocate and apportion its income for any taxable year in which an ACRS addition was reported the Virginia income tax paid for such year shall be the tax attributable to the ACRS addition (net of any allowable ACRS subtraction) after apportionment.~~

~~3. Examples.~~

~~a. Newco, Inc. is incorporated in 1986 and dissolved in 1988. Newco reports ACRS additions of $1,000 on its 1986 return and $1,500 on its 1987 return. Newco's outstanding balance of excess cost recovery is $2,500, all of which is reported on the 1988 final return under §6. Since Newco only has sufficient income in 1988 to offset $1,000 of the final post 1987 ACRS subtraction, Newco has $1,500 of unrecovered outstanding balance of excess cost recovery eligible for a refund under §7 A. The refund amount would be $90 ($1,500 X 6%) under §7 B 1; however, under §7 B 2 the refund is limited to $24 (the tax of $60 actually paid in 1986 and 1987 attributable to the ACRS additions less the tax of $36 attributable to the ACRS additions less the tax of $36 attributable to the post-1987 subtraction in 1988). The calculation of the limitation is shown below:~~

~~1986 1987 1988~~

~~---~~

~~With W/O With W/O With W/O~~

~~ACRS ACRS ACRS ACRS ACRS ACRS~~

~~Income after other~~

~~Va. modifications~~	~~2,000~~	~~2,000~~	~~500~~	~~500~~	~~1,000~~	~~1,000~~
~~ACRS addition~~	~~1,000~~	~~*~~	~~1,500~~	~~*~~		
~~Post-1987 ACRS sub.~~					~~2,500~~	~~*~~
~~Va. taxable income~~	~~3,000~~	~~2,000~~	~~2,000~~	~~500~~	~~(1,500)~~	~~1,000~~
~~Apportionment factor~~	~~25%~~	~~25%~~	~~50%~~	~~50%~~	~~60%~~	~~60%~~

~~Income of a multistate 750 500 1,000 250 (900) 600~~

~~Tax (6/%) 45 30 60 15 0 36~~

~~Difference (i.e., tax~~

~~attributable to ACRS~~

~~modifications) 15 45 (36)~~

~~FN* ACRS modification excluded to compute the limitation~~

~~Therefore, the limitation on the refund is $24 (15 + 45 - 36).~~

~~b. James Smith moved to Virginia in 1987 and was required to report an ACRS addition in the amount of $6,000 on his 1987 return. His outstanding balance of excess cost recovery is $6,000 which will be subtracted in 1988 and 1989. After filing his 1989 return, Mr. Smith still has $2,000 of the outstanding balance of excess cost recovery which has not offset income and requests a refund in the amount of $115 (2,000 X 0.0575). However Mr. Smith's refund is limited to $66, (the tax of $266 actually paid in 1987 attributable to the ACRS additions less the tax of $200 attributable to the ACRS additions less the tax of $200 attributable to the post-1987 subtractions in 1988 and 1989). The calculation of the limitation is shown below:~~

	~~1987~~	~~1988~~	~~1989~~

	~~With~~	~~W/O~~	~~With~~	~~W/O~~	~~With~~	~~W/O~~
	~~ACRS~~	~~ACRS~~	~~ACRS~~	~~ACRS~~	~~ACRS~~	~~ACRS~~
~~Federal Adj. Gross Income~~	~~6,000~~	~~6,000~~	~~17,000~~	~~17,000~~	~~3,800~~	~~3,800~~
~~Additions (except ACRS)~~	~~0~~	~~0~~	~~0~~	~~0~~		

~~Subtractions (except ACRS) 0 0 0 0~~

~~Va. Personal Exemption 700 700 800 800 800 800~~

~~Va. Standard Deduction 2,000 2,000 2,700 2,700 3,000 3,000~~

~~Taxable income before ACRS 3,300 3,300 13,500 13,500 0 0~~

~~ACRS Addition 6,000 *~~

~~ACRS Subtraction~~

~~Post 1987 ACRS subtraction 4,000 * 2,000 *~~

~~Virginia taxable income 9,300 3,300 9,500 13,500 (2,000) 0~~

~~Tax 335 69 345 545 0 0~~

~~Difference (i.e., tax~~

~~attributable to ACRS mod.)~~	~~266~~	~~(200)~~	~~0~~

~~FN* ACRS modification excluded to compute the limitation~~

~~Therefore, the limitation on the refund is $66 (266 - 200 - 0).~~

~~C. When to file the application for refund.~~

~~1. The application for refund may be filed after filing final federal and Virginia income tax returns as provided in 23VAC10-120-65 or after filing the income tax return for the last taxable year specified under 23VAC10-120-63 for claiming a post-1987 ACRS subtraction.~~

~~2. An application for refund must be filed within three years of the applicable date.~~

~~a. In the case of a final federal and Virginia return due to the death or dissolution of a taxpayer, the applicable date is the later of July 1, 1988, for a final return for a period beginning before January 1, 1988, or the due date of the final return for a period beginning on or after January 1, 1988.~~

~~b. In the case of an application for refund of unrecovered taxes paid on the outstanding balance of excess cost recovery, the applicable date is the due date of the last return on which the taxpayer is entitled to claim a subtraction under 23VAC10-120-63 or 23VAC10-120-64. A calendar year individual may file such application after filing the income tax return for 1989. A calendar year corporation may file such application after filing the income tax return for 1992.~~

~~D. Form of application. Any application for refund of unrecovered taxes paid on the outstanding balance of excess cost recovery shall be filed by a letter to the Tax Commissioner requesting the refund or by amended return. The letter shall provide sufficient documentation to demonstrate that the amount of refund requested does not exceed the amount specified in subdivision B 2 of this section (tax actually paid).~~

~~E. Accelerated application for refund. A corporation which would be entitled to file an application for a refund under this section may apply to the Tax Commissioner for permission to claim the refund in an earlier taxable year. The Tax Commissioner shall have the authority, at his discretion, to allow the refund to be claimed in an earlier taxable year if the taxpayer has demonstrated to the satisfaction of the Tax Commissioner that:~~

~~1. The taxpayer has paid Virginia income tax with respect to its outstanding balance of excess cost recovery,~~

~~2. The taxpayer has not recovered any portion of the outstanding balance of excess cost recovery,~~

~~3. The taxpayer will be required to file a Virginia income tax return for each year in which a subtraction is allowable under 23VAC10-120-63 and 23VAC10-120-64,~~

~~4. The taxpayer can reasonably expect never to have any federal taxable income or Virginia taxable income to offset the subtractions allowable under 23VAC10-120-63 and 23VAC10-120-64, and~~

~~5. No other taxpayer may claim or has claimed a subtraction or a refund with respect to the taxpayer's outstanding balance of excess cost recovery by reason of 23VAC10-120-67 A or 23VAC10-120-63 D.~~

~~6. Example. A Real Estate Investment Trust (REIT) is required to distribute its income to shareholders and generally has no federal taxable income subject to tax. Because items of income and deduction do not have the same character in the hands of a REIT's shareholders, the ACRS modifications do not flow through to the shareholders. Therefore, a REIT can reasonably expect never to have any~~

~~federal taxable income or Virginia taxable income to offset the subtractions allowable under 23VAC10-120-63 and 23VAC10-120-64, and would qualify for the immediate refund under this subsection.~~

~~F. Interest. No interest shall be paid on refunds made under this section.~~

~~23 VAC 10-120-67. Excess cost recovery; special rules.~~

~~A. Successor entities. In computing the outstanding balance of excess cost recovery a taxpayer may include ACRS additions and ACRS subtractions made by other taxpayers in the following situations:~~

~~1. A surviving spouse may include ACRS additions and ACRS subtractions made on a joint or combined Virginia return with the decedent.~~

~~2. A corporate taxpayer may include ACRS additions and ACRS subtractions made by another corporation if there has been a merger or other form of reorganization under the following conditions:~~

~~a. The taxpayer would be allowed under federal law to claim a net operating loss deduction based upon a net operating loss incurred by the other corporation, assuming such other corporation incurred a net operating loss.~~

~~b. A statement shall be attached to the return setting forth:~~

~~(1) The name and taxpayer I.D. No. of such other corporation,~~

~~(2) Details of the ACRS additions, ACRS subtractions and post-1987 ACRS subtractions claimed by such other corporation,~~

~~(3) An explanation of the relationship between the taxpayer and such other corporation, and~~

~~(4) A statement signed by the taxpayer to the effect that the post-1987 ACRS subtraction has not, and will not, be claimed by any other taxpayer on any other return, including the final return of such other corporation.~~

~~3. A successor entity which elects to include ACRS additions and ACRS subtractions of another taxpayer in its outstanding balance of excess cost recovery shall not be eligible to apply for a refund under 23VAC10-120-66 due to the final federal and Virginia return of such other taxpayer.~~

~~B. Multiple recovery prohibited. A taxpayer may not claim a subtraction under 23VAC10-120-63 or 23VAC10-120-64 or a refund under 23VAC10-120-66 with respect to any portion of the outstanding balance of excess cost recovery which such taxpayer or any other taxpayer has previously recovered.~~

~~C. Net operating losses.~~

~~1. In the case of net operating losses occurring in a taxable year beginning before January 1, 1988:~~

~~a. A federal net operating loss deduction with respect to such loss which is claimed in a taxable year beginning before January 1, 1988, shall carry with it the ACRS additions and ACRS subtractions as provided in subdivision B 5 (iii) of 23VAC10-120-100 and 23VAC10-20-70.~~

~~b. A federal net operating loss deduction with respect to such loss which is aclaimed in a taxable year beginning on and after January 1, 1988, shall not carry with it any ACRS additions or ACRS subtractions.~~

~~c. In computing the outstanding balance of excess cost recovery, the ACRS additions and ACRS subtractions for the loss year shall be included only once, for the year of the loss. Amounts carried to other years with the federal net operating loss deduction shall be ignored.~~

~~2. For net operating losses occurring in a taxable year beginning on and after January 1, 1988, a federal net operating loss deduction with respect to such loss shall not carry with it any portion of the subtraction allowable under 23VAC10-120-63 and 23VAC10-120-64.~~

~~23VAC10-120-290. Energy income tax credit.~~

~~A. Effective for taxable years beginning on and after January 1, 1983, a credit is allowed against the income tax liability of a corporation for a portion of "renewable energy source expenditures" as defined by Section 44C of the Internal Revenue Code (IRC) of 1954 (as amended 1982) and the regulations thereunder except as modified by this section.~~

~~1. Termination of federal credit. If the federal renewable energy source income tax credit is terminated prior to January 1, 1988, all references herein to IRC Section 44C and its accompanying regulations shall mean the statute and regulations as they exist at the date of termination.~~

~~2. Qualifying expenditures. This credit is applicable only to qualifying renewable energy source expenditures (as defined in subsection B below) installed in, on or in connection with a building or complex of buildings located in Virginia. No credit is allowed for energy conservation expenditures regardless of the fact that such expenditures also qualify for federal credit under IRC Section 44C.~~

~~3. Credit amount. A credit, in the amounts set forth below, but not in excess of $1,000 per expenditure, is allowable for expenditures made within the specified time period. An expenditure will be deemed made when original installation of the renewable energy source property is completed or, in the case of an expenditure~~

~~in connection with the construction or reconstruction of a building, when the building is completed and available for use by the taxpayer. See subdivision C 1.~~

~~% of Expenditure Allowable as Credit~~	~~Period in Which Expenditure is Made~~
~~25%~~	~~January 1, 1983 through December 31, 1984~~

~~20%~~	~~January 1, 1985 through~~
	~~December 31, 1985~~
~~15%~~	~~January 1, 1986 through~~
	~~December 31, 1986~~
~~10%~~	~~January 1, 1987 through~~

~~December 31, 1987~~

~~Renewable energy source expenditures made prior to January 1, 1983, or after December 31, 1987, do not qualify for this credit.~~

~~4. Limitations and carryover. Only one $1,000 credit is allowed for each expenditure. The credit allowable in any taxable year may not exceed the actual tax liability of a corporation for such year; however, if an otherwise allowable credit exceeds the tax liability, such excess may be carried forward to the succeeding taxable year until used. No excess credit may be carried to a taxable year beginning on or after January 1, 1989.~~

~~B. The term "renewable energy source expenditures" means an expenditure by a corporation subject to Virginia income tax made on or after January 1, 1983 and before January 1, 1988 for renewable energy source property (as defined below) installed and located in Virginia.~~

~~The term "renewable energy source expenditure" does not include any expenditure made for, or allocable to, any of the following:~~

~~(i) labor of the taxpayer;~~

~~(ii) a swimming pool or other energy storage medium whose primary function is other than the storage of energy;~~

~~(iii) the cost of maintenance of an installed system; or~~

~~(iv) the cost of leasing renewable energy source property.~~

~~The term "renewable energy source property" includes any solar energy property, wind energy property, geothermal energy property, or certain property specified by the Secretary of the U.S. Treasury as these terms are defined in Section 44C IRC and Treasury Regulation Section 1-44C-2, except that:~~

~~a. References to a "dwelling" shall be interpreted to mean "building or complex of buildings."~~

~~b. Restrictions to "principal residence" and "residential use" shall be ignored.~~

~~C. 1. When expenditures are treated as made. In general, an expenditure is treated as made when original installation of the renewable energy source property is completed. In the case of renewable energy source property which is included in the construction of a new building or the reconstruction of an existing building, the expenditure is treated as made when construction has progressed to the point where the building may be put to its intended use by the taxpayer~~

~~even though comparatively minor items remain to be finished or performed in order to conform to the plans or specifications of the completed building.~~

~~2. Expenditures financed with federal, etc., grants. Qualified expenditures financed with Federal, State or other grants shall be taken into account for purposes of computing the energy credit only if such grants are subject to Virginia income tax.~~

~~3. Joint occupancy. If two or more corporations (or other persons) jointly occupy a building or complex of buildings during any portion of a calendar year, the amount of the credit allowable by reason of renewable energy source expenditures shall be determined by treating all of the joint occupants as one corporate taxpayer whose taxable year is such calendar year. The credit shall be allocated to such joint occupants according to the expenditures of each joint occupant.~~

~~4. Joint ownership. If renewable energy source property is owned by two or more corporations (or other persons) and such property serves two or more buildings or complex of buildings then each corporation may treat its share of the cost of such property as a separate expenditure related to its own building or complex of buildings.~~

~~Example. Corporation A, B and C own buildings in an industrial park. A owns one building, B owns two buildings, C owns one building, but it rents to D, a corporation. The corporations agree to build a solar hot water heater to serve the four buildings, the cost to be divided on a per building basis. The renewable energy source property is completed on November 1, 1984 at the cost of $40,000. Corporation A's share of the expenditure is $10,000 and may claim a credit of $1,000 (10,000 X 25%, limited to $1,000). Corporation B's share of the expenditure is $20,000 and may claim a credit of $1,000 (20,000 X 25% limited to $1,000 for the complex of buildings.) Corporation C and D are treated as joint occupants and their share of the expenditure is $10,000. If C and D each pay half of the cost for the building, each may claim a credit of $500.~~

~~5. Recordkeeping. A taxpayer claiming an energy income tax credit shall maintain records that clearly identify the renewable energy source property with respect to which an energy income tax credit is claimed, and substantiate its cost to the taxpayer, any labor costs properly allocable to the onsite preparation, assembly or original installation of renewable energy source property which is paid for by the taxpayer, and the method used for allocating such labor costs. Such records shall be retained so long as the contents thereof may become material in the administration of the Virginia income tax.~~

~~6. Separate expenditures, effect on $1,000 limitation. All costs incurred in purchasing, constructing and installing a renewable energy source system in, on or in connection with a building, or complex of buildings, shall be considered a single expenditure. All renewable energy source property installed in, on or in connection with a building, or a complex of buildings, shall be deemed part of a single system.~~

~~In the case of a renewable energy source system consisting of separate components capable of functioning independently, which are installed or constructed in stages, the energy income tax credit may be claimed with respect to each component as each is completed, provided that no more than $1,000 is claimed as a credit with respect to the entire system.~~

~~7. Carry over of unused credit to subsequent years. If any portion of an otherwise allowable energy income tax credit is not used solely because it exceeds the income tax liability of the corporation, the unused portion of the credit may be carried to the succeeding taxable year and added to any credit allowable for that taxable year. No credit is allowable for expenditures made on or after January 1, 1988, however a credit can be carried to the succeeding taxable year beginning on or after January 1, 1988. No credit can be carried to a taxable year beginning on or after January 1, 1989.~~

~~23 VAC 10-120-360. Intragroup transactions; definitions.~~

~~The following words and terms, when used in this regulation, shall have the following meanings unless the context clearly indicates otherwise:~~

~~"Arm's length" means a charge for goods or services such that the price structure of intragroup transactions is substantially equivalent to the price structure of transactions between unrelated taxpayers, each acting in its own best interest.~~

~~"Group" means two or more corporations, which are owned or controlled, directly or indirectly by the same interests. Corporations eligible for inclusion in a federal consolidated return are members of a group. However, corporations ineligible for inclusion in a federal consolidated return (e.g., 79% stock ownership) are not precluded from being part of a group for purposes of this regulation if other facts demonstrate that one corporation has sufficient influence over another corporation's affairs to cause the corporations to enter into transactions with each other on terms that would not be offered to unrelated parties.~~

~~"Intragroup transaction" means a sale, exchange, or transfer of property or services between members of a group.~~

~~23 VAC 10-120-361. Factors utilized in determining whether intragroup transactions distort income from business done in Virginia.~~

~~A. A group's collective income from business done in Virginia is considered to be distorted if all of the following elements exist:~~

~~1. There is an arrangement;~~

~~2. Between one or more members of a group subject to Virginia income tax, engaging in one or more intragroup transactions;~~

~~3. Where the consideration for an intragroup transaction does not accurately reflect the income from business done in Virginia of the participating group members; and~~

~~4. The intragroup transaction has the purpose or effect of distorting income from business done in Virginia.~~

~~B. Group members' transactions with unrelated parties are relevant, but not conclusive, in determining whether income from business done in Virginia is accurately reflected in intragroup transactions. If the consideration paid for fungible goods or services in an intragroup transaction is equivalent to the price charged in an arm's length transaction between unrelated parties, the intragroup transaction will be deemed to reflect accurately income from business done in Virginia.~~

~~C. Factors creating a rebuttable presumption that income from business done in Virginia is distorted include, but are not limited to:~~

~~1. Whether intragroup services are rendered or received without adequate consideration;~~

~~2. Whether a member of the group has a significant amount of capital gains, interest, dividend, or similar income, with only minimal capital, activity, or expenses because essential corporate functions are performed for the group member by other group members without an arm's length charge;~~

~~3. Whether there are significant intragroup lending transactions other than those described in subdivision E 3 of this section, especially where the lending party has no other significant activity, and the source of funds is either (i) dividends or capital contributions by other members of the group, if a substantial portion of the funds received is loaned to any member of the group within 24 months of the dividend or contribution and the loan provides working capital to the borrower; or (ii) borrowed funds guaranteed by, or secured by the property of, a group member other than the lending party;~~

~~4. Whether tangible or intangible property was contributed to or acquired from a group member in anticipation of a sale to an unrelated party;~~

~~5. Whether the accounting records of a group member adequately reflect the unconsolidated information required for the Virginia income tax returns of group members with Virginia nexus; or~~

~~6. Whether a corporate group engages in such a high level of transactions which are not made on an arm's length basis that separate or combined group return filing cannot accurately represent the group's income from business done in Virginia.~~

~~D. If any transaction between members of a corporate group and a noncorporate entity or entities distorts income from business done in Virginia, §58.1-445 of the Code of Virginia may be invoked in order to accurately reflect the income from business done in Virginia of all participating entities.~~

~~E. Intragroup transactions listed below are examples of transactions deemed not to cause a distortion of the participants' income from business done in Virginia. The following transactions are not all inclusive, and are merely listed as safe harbors.~~

~~1. Patent or similar intangible asset.~~

~~a. If a patent or similar asset is transferred to or from an entity subject to Virginia income tax to another group member or noncorporate entity, two-thirds of the~~

~~taxable income to be derived from the patent must have been received by the transferor prior to the transfer.~~

~~b. If the taxable income to be derived from a patent or similar asset is undeterminable (in some instances, for example, a trademark), a transferor must receive a minimum payment equivalent to the asset's development cost, plus the transferor's stated internal rate of return requirement for similar assets created in the ordinary course of the transferor's business, plus a reasonable amount for anticipated future profits.~~

~~c. If a patent or similar asset is transferred between group members, with the transferor's compensation being future royalty payments, those payments must be at an arm's length price.~~

~~2. Stock representing corporation ownership or similar assets. If stock or a similar asset is transferred for less than its fair market value to or from a group member or noncorporate entity, then on any subsequent sale of the stock, the stock must have been held by the transferee for a minimum of five years before sale or transfer by the transferee. Otherwise, the provisions of subdivision C 4 of this section apply. See Example F.~~

~~3. Lending transactions. In an intragroup lending transaction, the lending party must be a discrete, separate business enterprise with its own employees, office~~

~~space, and books and records. Funds must be loaned at a fair market value interest rate, with collateral, payments, and credit standing substantially similar to those which the borrower could obtain from an unrelated lending institution.~~

~~4. Transfer of receivables. Intragroup transfers of receivables must occur at arm's length, taking into account: the creditworthiness of the underlying debtor or debtors, the collectibility of the transferred receivables, and the rate of return required by the transferor corporation with regard to similar assets.~~

~~23 VAC 10-120-362. Circumstances under which taxpayers may request that 23 VAC 10-120-360 through 23 VAC 10-20-364 be applied to intragroup transactions.~~

~~In extraordinary circumstances a taxpayer may request permission to allow an adjustment under §58.1-446 of the Code of Virginia on the grounds that income from business done in Virginia is substantially distorted as a result of law or policies peculiar to Virginia. Before such an adjustment is claimed on a Virginia return or amended return, permission must be granted by the department. An adjustment will not be permitted under this section if the claimed distortion is attributable to allocation and apportionment provisions for which the taxpayer may request an alternate method of allocation and apportionment under §58.1-421 of the Code of Virginia.~~

~~23 VAC 10-120-363. Intragroup transactions; accurately reflecting the income from business done in Virginia.~~

~~The following remedies may be applied, either alone or in combination, if income from business done in Virginia is found to be distorted under 23VAC10-120-361. Other remedies not listed herein may be incorporated as necessary.~~

~~1. Income reattribution. Income may be imputed or reattributed from the group member originally reporting it to another group member, in order to accurately reflect the income from business done in Virginia of the reporting group member.~~

~~2. Expense reattribution. Expenses may be imputed or reattributed from the group member originally reporting them to another group member, in order to accurately reflect the income from business done in Virginia of the reporting group member.~~

~~3. Consolidated income. A group may be required to compute an apportioned tax on its consolidated income from business done in Virginia, including the income of all group members engaged in the intragroup transactions that distort income from business done in Virginia.~~

~~4. Lookback rule. If an asset is transferred in an intragroup transaction at other than fair market value, the department may examine the transferee's profits on the asset in order to ascertain that the consideration for the transfer accurately reflects income from business done in Virginia. If it can be determined that the transfer was for substantially less than fair market value, the department may adjust the original transfer price of the asset, reattribute the profit to the transferor, or may consolidate the Virginia returns of the transferor and transferee, depending upon the facts and circumstances. This rule will be utilized in conjunction with the safe harbor provision in 23VAC10-120-361 E 2.~~

~~23 VAC 10-120-364. Intragroup transactions; examples.~~

~~A. A corporate group has the following members: a parent company (P) (not subject to Virginia income tax), a "financial corporation" (a subsidiary of the parent) not subject to Virginia income tax, or Delaware income taxation under Delaware Corporation Income Tax Code §1902(b)(8) (D Corporation), a subsidiary (S) of the parent (files a Virginia income tax return on a separate basis), and other members unimportant to this example.~~

~~D borrows a sum of money from an unrelated third party, guaranteed by S, and then loans this money to S. S makes an annual interest payment to D equal to the interest rate charged to D by the third party, plus a percentage of the interest~~

~~as a "management fee." D is not a "discrete business," because it has no employees, office space, and all decisions with regard to its activities are made by personnel of the parent company.~~

~~This transaction distorts income from business done in Virginia because employees of D rendered no services to S for which a management fee would accurately reflect income from business done in Virginia. Therefore, one appropriate remedy would be to disallow S's deduction for the management fee expense.~~

~~B.1. Assume the same facts as in A, except that D is a subsidiary of S, that S personnel govern D's day-to-day activities, and that the majority of the numerous transactions conducted between S and D are not at arm's length.~~

~~In this instance, an appropriate remedy would be to require a Virginia consolidated return, comprised of S and D, in order to accurately reflect the income from business done in Virginia of the group as a whole.~~

~~2. Assume the same facts as in B 1, except S does not have adequate income or assets to guarantee the amount borrowed by the D, and that instead, the parent guarantees this loan. Assume further that the group originally filed a Virginia combined return, that the accounting records of the entire group do not support the separate company results of the group as shown in its Virginia income tax~~

~~return, and that it is not possible to obtain the separate company operating results in a manner which may be verified through an audit.~~

~~In this instance, an appropriate remedy would be to require a Virginia consolidated return, comprised of the parent, S, and the D, in order to accurately reflect the income from business done in Virginia of the group as a whole.~~

~~C. Assume the same facts as in B, except that there is no intragroup loan activity. Instead, assume that S develops a patent, transfers the ownership to D for nominal consideration, and pays a royalty to D, which S deducts in determining income from business done in Virginia. The only function of D is the holding of patents.~~

~~This transaction distorts income from business done in Virginia because the consideration for the transfer of the patent did not reflect its fair market value at the time of the transfer.~~

~~One remedy is a disallowance of the royalty expense in computing S's income from business done in Virginia. Another possible remedy in this situation would be to consolidate the income of S and D, in order to accurately compute income from business done in Virginia, if there is such a high level of interaction between the two companies that it is impractical to utilize any other reporting method of determining the group's income from business done in Virginia.~~

~~D. Assume that the following group exists: a parent (P) (subject to Virginia income tax), S3 (a corporation with no assets or employees, not subject to Virginia income tax), and S4 (a subsidiary of the parent, subject to Virginia income tax).~~

~~The parent transfers its ownership interest in S4 to S3, by transferring S4's stock for nominal consideration. A short time after the transfer, S3 sells the S4 stock, realizing a substantial gain, which would have been income from business done in Virginia to the parent had the parent sold the stock.~~

~~This transaction distorts P's income from business done in Virginia because the stock transfer appears to have been made in anticipation of a sale to an unrelated party.~~

~~Under these facts, it is a rebuttable presumption that an appropriate remedy is to reattribute the capital gains income to P. Another possible remedy is to require P and S4 to file a consolidated Virginia income tax return, if the accounting records are not sufficient to support any other filing method.~~

~~E. D Corporation, a wholly owned subsidiary of P, is a "financial corporation" not subject to Delaware income taxation under Delaware Corporation Income Tax Code §1902(b)(8). P is subject to Virginia income tax. D leases an office for its exclusive use in Delaware where it has a staff adequate to conduct all of its~~

~~business affairs. D has substantial intangible assets which are loaned or otherwise made available to other group members for a consideration determined pursuant to the safe harbor provision of subdivision E 3 of 23VAC10-120-361. All of D's assets are located in Delaware, and all of its business activities, including all day-to-day decision making, are conducted by its own officers and employees in Delaware. D received its intangible assets from P in a transaction under Internal Revenue Code §351.~~

~~In this instance, the group's income from business done in Virginia is not distorted due to the intragroup lending transactions. This conclusion is not changed by the mere fact that one or more officers or directors of D may reside in Virginia, or may be employed by an affiliate of D doing business in Virginia.~~

~~F. Same facts as in E, above, except that there are no intragroup lending transactions. Assume that P transfers its 100% stock ownership interest in subsidiary B to D, the financial corporation. Three years after the stock transfer, P decides that it needs to raise capital, and causes D to sell its B stock, at a substantial profit over P's original basis. In this instance, there is no distortion of the group's income from business done in Virginia, because the taxpayer can establish that the original stock transfer to D was not in anticipation of a subsequent sale.~~

~~G. P corporation is a pharmaceutical company subject to Virginia income tax. S corporation, a wholly owned subsidiary of P corporation, is incorporated in another state and not subject to Virginia income tax. S corporation is engaged solely in the business of developing marketable products utilizing patents developed by P corporation. P transfers all of its patents to S at their estimated fair market value at the date of transfer. S has its own officers, employees, accounting records, and regularly earns income from outside the group in the ordinary course of business. Further, the transfer of patents in this manner is consistent with the pharmaceutical industry's method of doing business.~~

~~After four years, S corporation sells one of the patents to an unrelated third party in the ordinary course of business for a substantial amount over the original purchase price paid to P, and in turn, for a substantial amount over P's basis.~~

~~Transactions of this nature do not cause a distortion of P's income from business done in Virginia, because P has established that the consideration for the transfer of its patents to S reflects fair market value, and that the transfer was not in anticipation of a subsequent sale by S to an unrelated party.~~